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SUBJECT: NEW GREEK FINANCE MINISTER ON GLOBAL FINANCIAL
CRISIS AND ITS IMPACT ON GREEK ECONOMY

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Summary

¶1. (SBU) In a February 13 courtesy call, the Ambassador discussed the global financial crisis and its impact on the Greek economy with Ioannis Papathanasiou, Greece's new Minister of Economy and Finance. The new Minister summarized his recent EcoFin meetings in Brussels, the revisions to the Greek Stability and Growth Program (SGP) -- the government's economic program under the European Monetary Union (EMU) -- and his thoughts on the major problems facing the Greek economy. The Minister's tone and rhetoric echoed his public statements that the global financial crisis would not impact the Greek economy too severely, begging the question of how realistic the GoG's analysis and projections are. While the new Minister appeared to have a fair grasp of the issues facing the country, he seemed to portray Greece as a victim of the global crisis and what he regards as unfair rumors that have driven up borrowing rates to which Greece is subject in international markets, taking little government (current and previous) ownership for the events and actions -- or lack of actions -- that have brought Greece to its current difficulties. End Summary.

The Minister's Background
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(2) (SBU) The Ambassador expressed his congratulations and desire to continue a cooperative relationship with the Ministry, and indicated that stabilizing the global economy is one of President Obama's top priorities. He and the Minister agreed that the economic crisis is a global problem requiring a global solution. The Minister, who is an electrical engineer by training and most recently held the position of Deputy Minister in the Ministry, stated that as a former President of the Athens Chamber of Commerce, his background is on the business and micro side of economics.

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EcoFin Meetings and Problems Facing Greek Economy
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(3) (SBU) The Minister indicated that the EcoFin meetings in Brussels during the week of February 9 went well, but it is not yet clear whether the EU will place Greece and other countries under EC monitoring for failure to hold their fiscal deficits under the Stability and Growth Pact target of 3 percent of GDP. The Minister insisted that there is no

danger of Greece leaving or being ejected from the EMU as a result of its fiscal deficit and high level of public debt. He said that this view was echoed by all EC officials at the EcoFin meetings. Papathanasiou went on to say that despite the public's focus on Greece's fiscal deficit (which the GoG projects to hold in 2009 at the 2008 level of 3.7 percent of GDP), the main problem facing the Greek economy today is an increase in borrowing costs which have compounded an already high level of public debt (the second highest in the EU, coming in at 94.6 percent of GDP in 2008 and projected by the GoG to reach 96.3 percent of GDP in 2009). He stated that until recently, the level of debt was not such an important issue. Since the financial crisis hit, however, the spreads Greece is charged to borrow in the international capital markets have spiked. Papathanasiou believes these spreads are unjustified solely on the basis of Greece's level of debt. In his opinion, the press has purposefully exacerbated divergence in the spreads by focusing on a series of negative events, including the December riots and the recent protests by farmers, and thereby creating an impression that Greece is in crisis and unable to service its current debt or to issue new debt.

(4) (SBU) Quite to the contrary, the Minister told the Ambassador, Greece faces no problems with borrowing on international markets. Year-to-date, the GoG already has raised over 40 percent of its 2009 financing needs in the debt markets. (Note: According to the GoG's 2009 budget, Greece must borrow approximately 42 billion euros in 2009 to finance its budget. Thus far, the GoG has raised the following: (1) 2.55 billion euros from a January 13 auction of short and medium-term bank notes; (2) 5 billion euros from a January 19 issuance of a syndicated 5-year bond; (3) 2.8 billion from a late-January private bond placement; and (4) 7 billion euros from a February 10 issuance of 3-year bonds.

It would appear that the GoG is front-loading its borrowing program, with the expectation that its spreads will continue to deteriorate over the course of the year. End Note.) While the Minister acquiesced that yield spreads on Greek bonds versus German government notes of similar maturity are higher (for example, the February 10 3-year bonds were sold to yield 249.2 basis points more than comparable German bonds), he emphasized that the interest rate on these bonds was 14 basis points lower than on similar bonds issued by Greece in June 2008. (Note: While true, interest rates in general have decreased as a result of cuts in rates by central banks. The spread between bonds, therefore, is a more important indication of the market's assessment of risk of one instrument verus another as opposed to interest rates on bonds issued today versus those issued several months ago. End Note.)

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GoG's Revised Projections and New Budget Measures in the SGP
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(5) (SBU) The Minister highlighted for the Ambassador the GoG's revised projections for GDP growth and the fiscal deficit. (Note: The previous Minister was widely criticized in the Greek and international press and by economic analysts for making projections in the 2009 budget, passed by Parliament in December, that seemed to be detached from the reality of the financial crisis and its impact on the Greek economy. End Note.) The new GoG projection for GDP growth in 2009 is 1.1 percent (down from 2.7 percent in the December budget). Papathanasiou believes this is a far more credible target than the European Commission's (EC) projection of 0.2 percent. While he did not specify how he thought this target could be achieved, he indicated his belief that the EC's target lacked a strong analytical basis. (Note: Recently, the Bank of Greece, Greece's central bank, has indicated it finds the GoG's 1.1 percent projection unrealistic, and believes a 0.5 percent growth rate for 2009 is more attainable in light of the global slowdown. End Note.)

(6). (SBU) The revised projection for the fiscal deficit in 2009 is 3.7 percent of GDP (up from 2.0 percent in the December budget and the same as that of 2008). According to the Minister, containing the fiscal deficit is the Prime Minister's and his Ministry's top priority. He believes the 3.7 percent target will be achieved by implementing measures included in the updated SGP to improve revenue collection and to cut expenditures. SGP revenue collection measures highlighted by Papathanasiou include an increase in the special tax on alcoholic beverages and cigarettes and simplification of the real property tax. SGP spending cuts highlighted by Papathanasiou include a 10 percent cut to all discretionary items in the budget, a 10 percent cut on all government contracts, a limitation on new civil servant hiring (fewer may be hired than retire), and salary ceilings on managers in public enterprises and organizations. Altogether, according to the Minister, these cuts give the GoG a 500 million euros "cushion" in the budget in the event revenues are below target, or additional social programs for the vulnerable are needed. Papathanasiou also indicated that the GoG's goal under the SGP is to bring the deficit under 3 percent of GDP by 2011.

Comment

¶7. (SBU) The Minister's tone and rhetoric in public, echoed somewhat in the meeting with the Ambassador, seem to lack a note of sobriety regarding the impact of the economic crisis on Greece. With daily announcements by governments and analysts worldwide projecting dismal outlooks for 2009, it seems unrealistic -- quixotic even -- to hint that Greece may not be impacted by the crisis as severely as others. Rather than hoping for the best and preparing for the worst, the GoG seems to be hoping for the best, preparing for the best -- and ignoring the rest. The Minister makes a plausible case that the GoG has developed more realistic targets than those outlined in the December budget, is dedicated to containing the fiscal deficit, and that the GoG's plan under the SGP can help achieve this goal. The Minister does not, however, seem to take into account risks to this strategy and to the GoG's projections. The entire GoG plan seems to hinge on tax earnings and cuts to government spending and, as such, is subject to a high level of risk as the global economy grinds to a "virtual halt," as the IMF has predicted. There is significant risk that government revenues will underperform

in 2009 as they did in 2008, but the GoG's SGP projects stronger tax earnings and a billion euros in earnings from privatizations of various entities, including those like Olympic Airways and the Thessaloniki port that have failed thus far to garner significant international financing. On the expenditure cutting side, the government seems to be doing more adding than subtracting. Since the mid-January cabinet reshuffle that brought Papathanasiou to his new posting, the Embassy's back of the envelope tally indicates that the GoG has committed over 2 billion euros in new programs, some of which have been politically motivated (see reftel). It would appear most of these funds are being offered without budgetary offsets, calling into question how concrete the SGP is and whether the GoG can really live up to its fiscal deficit target.

¶8. (SBU) Moreover, the fact that the Minister portrays Greece as a victim of unfair rumors in the press that have helped exacerbate Greece's costs of borrowing gives one the impression that this government is not taking ownership of Greece's economic difficulties. Certainly, the December riots and other signs of civil unrest may have contributed to a widening yield spread between Greek and German state bonds, but the ultimate factors are an increasing fiscal deficit and a huge national debt -- two issues to which this and previous governments paid only lip service in the years preceding the

financial crisis. We fear that this reluctance to take ownership, coupled with overly optimistic statements in the press, could give the markets the impression that this government is not serious about fiscal discipline and further structural reforms. In the end, this impression will simply exacerbate Greece's problems. End Comment.
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